

carryovers on termination of the trust (or estate) under section 642(h).

(c) The separate share rule may be applicable even though separate and independent accounts are not maintained and are not required to be maintained for each share on the books of account of the trust (or estate), and even though no physical segregation of assets is made or required.

(d) Separate share treatment is not elective. Thus, if a trust (or estate) is properly treated as having separate and independent shares, such treatment must prevail in all taxable years of the trust (or estate) unless an event occurs as a result of which the terms of the trust (or estate) instrument and the requirements of proper administration require different treatment.

[T. D. 6500, 25 FR 11814, Nov. 26, 1960; 25 FR 14021, as amended by T.D. 8849, 64 FR 72543, Dec. 28, 1999]

#### § 1.663(c)-2 Rules of administration.

(a) *When separate shares come into existence.* A separate share comes into existence upon the earliest moment that a fiduciary may reasonably determine, based upon the known facts, that a separate economic interest exists.

(b) *Computation of distributable net income for each separate share—(1) General rule.* The amount of distributable net income for any share under section 663(c) is computed as if each share constituted a separate trust or estate. Accordingly, each separate share shall calculate its distributable net income based upon its portion of gross income that is includible in distributable net income and its portion of any applicable deductions or losses.

(2) *Section 643(b) income.* This paragraph (b)(2) governs the allocation of the portion of gross income includible in distributable net income that is income within the meaning of section 643(b). Such gross income is allocated among the separate shares in accordance with the amount of income that each share is entitled to under the terms of the governing instrument or applicable local law.

(3) *Income in respect of a decedent.* This paragraph (b)(3) governs the allocation of the portion of gross income includible in distributable net income that is income in respect of a decedent

within the meaning of section 691(a) and is not income within the meaning of section 643(b). Such gross income is allocated among the separate shares that could potentially be funded with these amounts irrespective of whether the share is entitled to receive any income under the terms of the governing instrument or applicable local law. The amount of such gross income allocated to each share is based on the relative value of each share that could potentially be funded with such amounts.

(4) *Gross income not attributable to cash.* This paragraph (b)(4) governs the allocation of the portion of gross income includible in distributable net income that is not attributable to cash received by the estate or trust (for example, original issue discount, a distributive share of partnership tax items, and the pro rata share of an S corporation's tax items). Such gross income is allocated among the separate shares in the same proportion as section 643(b) income from the same source would be allocated under the terms of the governing instrument or applicable local law.

(5) *Deductions and losses.* Any deduction or any loss which is applicable solely to one separate share of the trust or estate is not available to any other share of the same trust or estate.

(c) *Computations and valuations.* For purposes of calculating distributable net income for each separate share, the fiduciary must use a reasonable and equitable method to make the allocations, calculations, and valuations required by paragraph (b) of this section.

[T.D. 8849, 64 FR 72543, Dec. 28, 1999]

#### § 1.663(c)-3 Applicability of separate share rule to certain trusts.

(a) The applicability of the separate share rule provided by section 663(c) to trusts other than qualified revocable trusts within the meaning of section 645(b)(1) will generally depend upon whether distributions of the trust are to be made in substantially the same manner as if separate trusts had been created. Thus, if an instrument directs a trustee to divide the testator's residuary estate into separate shares (which under applicable law do not constitute separate trusts) for each of the testator's children and the trustee is